CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 370

January 11, 1974

COMBINATION OF GENERAL AND FINANCIAL CORPORATIONS

Syllabus:

Where a unitary business includes both general corporations and financial corporations such corporations are to be included in a combined report.

Advice has been requested as to whether general corporations and financial corporations are to be included in a common combined report when both are components of the same unitary business.

It has long been settled law in California that a unitary business must file a combined report and apportion its income by formula. Butler Brothers v. McColgan, 17 Cal.2d 664 (1941) affirmed 315 U.S. 501 (1942); Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 (1947); Chase Brass and Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496 (1970) appeal dismissed 400 U.S. 961 (1970). No persuasive reason has been advanced to depart from this mandatory rule when the unitary entitles include financial as well as general corporations.

The combination is to be accomplished in accordance with the following rules:

1. The total business income of the general corporations and the financial corporations will be apportioned by means of a three factor formula of property, payroll and sales.

2. Intangible personal property shall be excluded from the property factor.

3. Sales of intangibles between members of the unitary group, if any, are considered intercompany sales and are excluded from the sales factor.

4. For sales factor purposes:

A. (1) Receipts from the sale, lease, rental or other use of real property, tangible personal property and intangible personal property shall be included in the numerator and denominator as provided in Reg. 25134 through 25137 except as indicated below.

B. (1) Interest income from debts in the nature of loans and installment obligations arising from within the unitary group shall be attributed to the

state where the office is located at which the customer applied for the loan, provided that the taxpayer is taxable in such state. Otherwise such income is assigned to the taxpayer's commercial domicile.

(2) Interest income from loans initiated by traveling loan officers shall be attributed to the state where the office out of which he operates is located.

(3) Receipts from vendor accounts receivable acquired from nonunitary entities shall be assigned to the state in which the debtor resides in the case of an individual or, if a corporation, to the state of the debtor corporation's commercial domicile, provided the taxpayer is taxable in such state; otherwise such receipts shall be assigned to the taxpayer's commercial domicile.

(4) Interest or service charges from credit card receivables and credit card holders' fees shall be attributed to the state in which the credit card holder resides in the case of an individual or, if a corporation, to the state of the corporation's commercial domicile, provided the taxpayer is taxable in such state. If the taxpayer is not taxable in the state of the individual card holder's residence or commercial domicile of the corporate card holder, such receivables shall be attributed to the state of the taxpayer's commercial domicile.

(5) Merchants' discount income derived from financial corporation credit card holders' transactions with merchants shall be attributed to the state in which the merchant is located, provided the taxpayer is taxable in such state. If the taxpayer is not taxable in the state in which the merchant is located, the merchants' discount income shall be attributed to the state in which the taxpayer's commercial domicile is located.

5. The rate of tax to be applied to the income attributable to California depends upon whether or not the financial corporation is "doing business" within California as that term is defined in Section 23101 of the Revenue and Taxation Code (as limited by Section 6450 of the Corporations Code). If the financial corporation is not doing business in California, then the entire portion of unitary income attributable to California is deemed to be derived by the general corporation and is taxed at the rate applied to general corporations as set forth in Section 23151 of the Revenue and Taxation Code.

If the financial corporation is doing business in California, then it is necessary to determine the rate of tax to be applied to the portion of income generated by the financial corporation. Section 5219 of the Revised Statutes of the United States (12 U.S.C.A., Section 548) provides that a financial corporation cannot be taxed at a rate less than the rate applied to national banks. Accordingly, the portion of the unitary income attributable to California must be divided into two components: one portion derived from general activities and taxed at the general rate, and one portion derived from financial activities and taxed at the rate applied to national banks. In

determining the portion of the income to be taxed at each rate, the "revised" method prescribed in Legal Ruling 234 will be used.

It is recognized that the combination of general and financial corporations represents a change in the administrative practice of the department. It is further recognized that the activities of the business community are dynamic and that new forms of organization and new transactional practices and techniques are emerging frequently. The rules set forth above may not in all cases result in a fair representation of the extent of a taxpayer's business activity in this state. Problems of this type are expected to arise particularly in cases where the financial corporation is the dominant factor in the combination. Where such is the case, a reasonable treatment shall be devised under Section 25137 of the Revenue and Taxation Code. Section 25137, however, will only be invoked in specific cases where unusual fact situations produce incongruous results. See Cal. Admin. Code, tit. 18, Reg. 25137.

Legal Ruling 119 is hereby withdrawn.